# Convergence Commentary

## December 2023 Market Recap

### Quick Hits:

- Equities rallied sharply.
- Three rate cuts signaled in 2024.
- The US consumer continues to spend.
- 2024 is ahead of us.

### Market-Moving Highlights

The Federal Reserve kept the rates steady as expected. In the last meeting in November, Jerome Powell said, "We are not even thinking about rate cuts," but during their meeting on December 13th, they signaled 3 rate cuts in 2024. The conference highlighted a faster than expected slowdown in inflation, and cooling of the labor market as reasons for being done with rate hikes. As the economy is currently still strong, the market has rallied behind the prospects of a soft landing. It is important to note, however, that in the past, the Federal Reserve has often cut down too late, causing a recession. Although the current data is very encouraging, it will be interesting to watch the Fed balance this risk.

Inflation fell right in line with expectations with CPI coming in at 3.1% year-over-year and 0.1% monthly. Core CPI stayed stable at 4%. However, other inflation indexes have surprised to the positive, as Producer Price Index (PPI) came in at 0% monthly, better than the 0.2% expected. The Core Personal Expenditure Index (Core PCE), came in at 0.1%, better than the 0.2% expected. The data in December reaffirmed the view that inflation progress continues to move in the right direction.

Similarly to November, the US consumer continues to spend. Concerns continued over the high level of debt, mainly driven by mortgage, credit card, and student loan balances, which have been steadily increasing. However, the delinquency rates remain remarkably low, with about 97% of the debt classified as non-delinquent. As mentioned before, the rise in debt could be attributed to high inflation as well as interest rates. On December 14th, retail sales surprised predictions and came in at 0.3% monthly, much better than the -0.1% expected. Consumer spending represents about 70% of GDP, and if the consumer spends, the economy should remain in good shape.

December has been a quiet month for DC, but there are funding deadlines looming. First up is the Supplemental Spending Bill, which is split into two deadlines – January 19th and February 2nd. Without action, the government agencies start to close on the 20th. It will be a test for the newly elected Speaker Mike Johnson to avoid a shutdown. The continued struggle for a final bill will create potential for headline risks in January.

## Index Performance

| Index | 1 Month | YTD | 1 Year | 5 Year |
|---|---|---|---|---|
| S&P 500 | 4.83% | 26.64% | 28.55% | 15.95% |
| Nasdaq Composite | 6.17% | 45.44% | 49.06% | 19.07% |
| Russell 2000 | 13.94% | 18.73% | 21.50% | 10.49% |
| MSCI ACWI ex US | 5.17% | 16.34% | 16.34% | 7.71% |
| Bloomberg US Aggregate Bond | 3.84% | 5.54% | 5.69% | 1.15% |

The Federal Reserve's dovish meeting signaling 3 rate cuts in 2024 was welcomed news for the market. The 10-year treasury rate further declined from 4.35% to 3.85%. On the emerging market front, India has been a surprise with an 8.32% monthly return. There has been a strong focus to digitalize their economy, with the financial segment strengthening. India has been one of the best emerging markets performers with 17.23% year-to-date returns. Chinese equities have continued to struggle as the government cracked down on game monetization. The regulatory onslaught, which started in late 2020, already shed more than $1 trillion in market value from Chinese companies. On the developed market side, Japanese equities have been an outlier for a while. Corporate reforms have been focused on bolstering investment. Investors were reminded that Japan is the third-largest stock market after the United States and China. It is also a refreshing diversification of geopolitical rivalry between the United States and China. The returns were 3.19% month-to-date and 19.42% year-to-date. While there was, unfortunately, a re-escalation in the Middle East, the war has not yet threatened the global economy. In our last market commentary, we referenced the sensitivity of small cap companies to interest rates. With the substantial fall in interest rates in the last two months, it is nice to see the Russell 2000 Index have a 15% rally in December.

## S&P 500 Sector Highlights & Commentary

| Best-Performing Sectors | | Worst-Performing Sectors | |
|---|---|---|---|
| Real Estate | 9.94% | Energy | 0.3% |
| Industrials | 7.2% | Utilities | 1.99% |
| Consumer Discretionary | 6.79% | Consumer Staples | 2.49% |

All the S&P 500 sectors were positive in December. The 30-year mortgage rates further declined from 7.29% to 7.01%. Real estate, as a bond proxy sector, has been in our best performing sectors for two months in a row for a 21.74% two-month return. Economic data have shown a surprisingly resilient consumer, aiding cyclical sectors. The worst-performing front is a repeat of last month. Decreasing oil prices have hurt the energy sector, while the strength of the economy continues to lower the appetite for defensive sectors. It is surprising to see utilities as a poor performer, as they are, similarly to real estate, a bond proxy sector. With treasury yields on the decline, utilities should benefit. The difference between the two is that real estate is a more cyclical sector, while utilities are defensive.

## What to Watch in January

*[Click here to read our reference guide for economic indicators.]*

*101/03 – Manufacturing PMI, FOMC Minutes*
*The ISM Manufacturing PMI was unchanged at 46.7 in November, below the forecasts of 47.6, signaling a continuing contraction in the manufacturing sector. The manufacturing sector is expected to continue in the contraction territory for the 13th consecutive reading, with the forecast at 47.3. The stance of the Federal Reserve has been communicated well, but the meeting minutes might contain some additional information.*

*01/05 – Non-Farm Payrolls*
*The US economy added 199,000 jobs in November, higher than the expectation of 180,000. The average monthly gain in the past year was 240,000. However, around 30k of the boost came from auto workers returning from strike. That means that the labor market is cooling, albeit slowly. Healthcare added 77,000 jobs, the highest of all sectors.*

*01/11 – CPI and Core CPI*
*The annual CPI has slowed to 3.1% in November. The expectations are for a further decrease to 3%. Core CPI is expected to stay steady at 4%. The stickiness is expected to come from shelter, car insurance, and recreation.*

*01/17 – Retail Sales*
*Retail sales have unexpectedly increased in November by 0.3% against the market expectations of -0.1%. The consumer is still stronger than any expectations, and while concerns over the amount of debt consumers have been growing, spending has yet to ease. The December reading is one of the tests of consumer strength.*

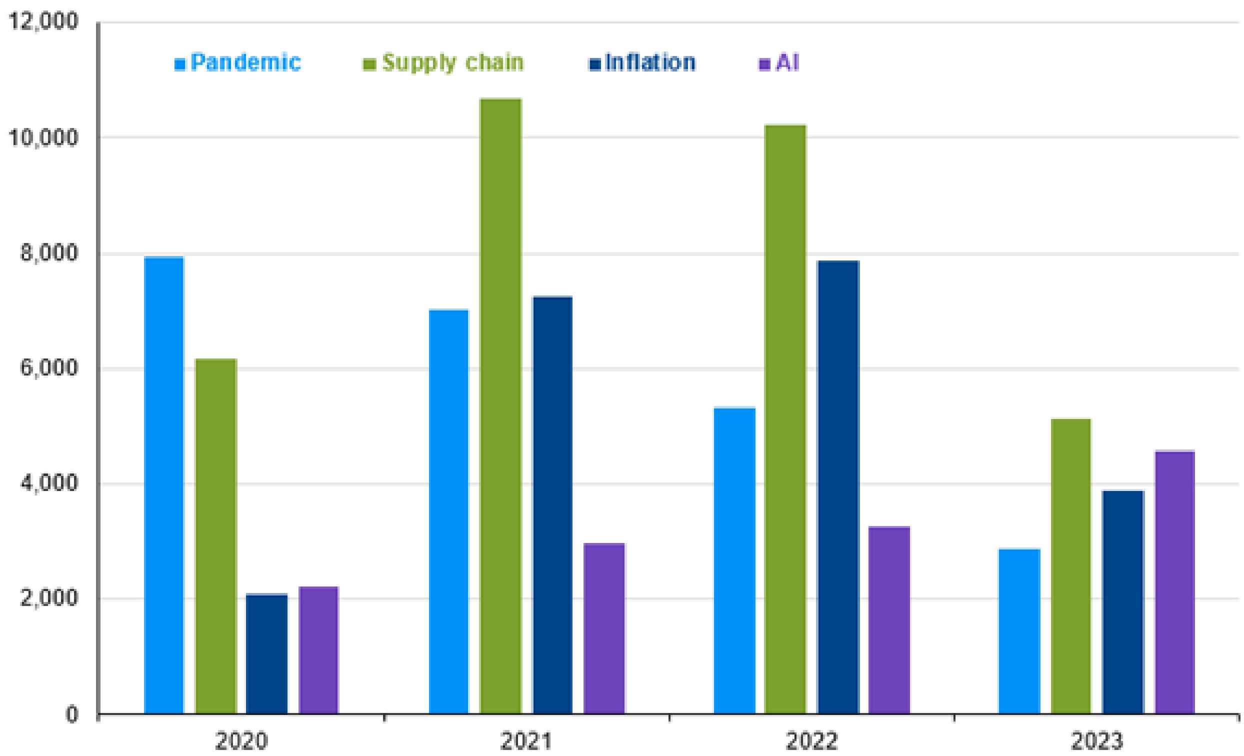
*01/10 – Michigan Consumer Sentiment Preliminary*
*Consumer sentiment has increased sharply from 61.7 to 69.4 in November. Expectations for inflation in the upcoming year dropped to 3.1% from 4.5%, driving the increase. It will be interesting to see the next reading after consumers have more time to digest the new data.*

*01/31 – Fed Interest Rate Decision*
*The Federal Reserve kept the fed funds rate steady at 5.25%-5.5%. The major shift was in the indication of 75bps of cuts in 2024. The expectation for the next meeting is that not much will change.*

## Market Wrap

December was a great wrap of the year for the markets. The narrative that inflation has come down while the economy and consumer remained strong has taken over. Next year, an entirely different dynamic will be playing out with the Federal Reserve, as rate cuts are often associated with a slowing economy. While we can only guess what the next year brings, it is safe (or is it?) to assume that elections will headline. Geopolitical tensions from the war in Ukraine and Middle East, to tensions between the US and China should remain in focus.

For some perspective, the below chart shows the mentions in earning call transcripts of US companies. The trend of AI having increasing mentions is likely. While supply chain issues have improved significantly, further improvement will be welcomed. The pandemic is hopefully behind us, while the inflation story is yet to be fully written.




## Sources

*[What themes will drive the market in 2024?]*

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## Your Investment and Research Team

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